— GangBanking —
THE BARINGS COVER-UP

A 'lone trader' has been blamed and imprisoned for the 1995 Barings Bank breakdown, but an international banking cabal has gone to extraordinary lengths to keep the real story suppressed.

Part 1

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Money never evaporates. All too often it may appear to 'disappear' or become lost in some *lira* limbo land, but in reality it is merely recycled into other hands. This is the governing rule to bear in mind when studying boom and bust cycles, stock market 'manipulations', bank collapses and all the other common or garden variety of financial ills that manifest themselves in this cash-rich society of ours. The Barings debacle is such an event.

The collapse of Barings bank on a cold February morning sent shudders of outrage through the financial fraternity of the City of London. It was not that Barings was a large bank, nor even that it was the oldest merchant bank in the land, that aroused these emotions. It was that the Chancellor of the Exchequer, Kenneth Clarke, did not consent to rescue the bank with government (taxpayers') money.

The press brayed with mighty indignation at this unbelievable betrayal of established Tory principle, observing that the Bank of England's historic role as 'lender of last resort' now lay in tatters. The government's message was clear. Henceforward, only the largest banks could expect to be bailed out in the event that they gamble with their depositors' money and lose. The smaller houses had better rethink their strategy <u>and</u> deeply reconsider their political donations policy to an ailing Conservative Party Central Office.

Five months later, the media were back on the attack once again. On this occasion the same columnists, feature writers and editors gave vent to their fury following the publication of the Bank of England's report on the investigation into the events leading to the collapse of Barings. The directors and management of Barings were condemned for their slack management and poor oversight that resulted in cumulative losses amounting to £927 million. Despite all the column inches and air time devoted to the debacle, not one report has attempted to expose the enormity of what took place.

From the very first day that the collapse of Barings hit the headlines, the legend of Nick Leeson, the 'lone trader', was trotted out to an unsuspecting public. At the same time, officials at the Bank of England went to great lengths to avoid asking difficult questions—a fact that becomes obvious following close scrutiny of their report. Likewise, these mandarins of money do not appear particularly fazed by the incredible lack of cooperation on the part of <u>all</u> of the involved parties. The latter, apparently, felt it necessary to withhold, suppress, destroy, corrupt or otherwise lose vital documents and other records that no doubt would have been of the greatest embarrassment to the Bank of England's inquiry team had they been unfortunate enough to come across them. In the event, they did not. Thus the real extent of criminality on the part of Barings' directors, and possibly others, cannot be catalogued.

This most recent of bank collapses gives us the opportunity to review the mechanisms by which a major financial scandal is nipped in the bud. It also demonstrates the remarkable supinity of the media who have not reported the multiplicity of shortcomings in the inquiry. Also apparent is the behind-the-scenes cooperation of all the major players who rally around in a desperate attempt to keep the public cocooned in the bewildering haze of a pre-solved whodunnit.

Leeson, who is desperate to return to England to face his punishment, rather than be interned in some dingy Singaporean gaol for 15-odd years, is keeping fairly quiet.[1] He and his solicitor, Stephen Pollard of Kingsley Napley, are apparently confident that they can negotiate something in exchange for Leeson's avowed desire to return to Britain to face a 'satisfactory' sentence. It is speculation (something Leeson and Barings know a great deal about) to suggest that the exchangeable 'something' may be Leeson's promise to take the whole rap.

Whatever the undertow, the 'lone trader' legend remains ridiculous.

THE SOUND OF ONE HAND CLAPPING IN UNISON

The Bank of England's tediously dull but majestically entitled "Report of the Board of Banking Supervision Inquiry into the Circumstances of the Collapse of Barings"[2] is a shining example of the lack of heuristic enterprise on the part of the inquiry team, and has some echoes of the discredited Warren Commission Report in that vital information was either not followed up or was altogether disregarded, but nonetheless it rapidly concludes that the lone trader (lone assassin) is to blame. The most salient points of the entire inquiry are summed up in the innocuous-sounding "Limitations on access to documents and individuals" section of the report. This section, more than the other 337 pages of the report combined, is the most revealing and has not been discussed in the press to any extent.

Firstly, Leeson, the man whose name is on everyone's lips and who is at the very centre of the scandal, was not interviewed. Displaying some small signs of displeasure at Leeson's refusal to be interviewed, the team did not, as might be expected, call for Leeson to be extradited to London and subjected to examination to reveal his knowledge of the events, despite the fact that he was pleading for this to happen. Instead, he was left to rot in a Frankfurt prison waiting extradition to Singapore.

The inquiry fared little better with Barings Plc. The team were not permitted direct access to Barings offices—anywhere. Formal conversations were held with some directors and staff in London, and some documents and records were provided when requested by the Bank of England. Knowing precisely which documents to request must have been problematic for the Old Lady's ace investigators. Other directors and staff, particularly in Singapore, were not permitted to be interviewed, nor were any Barings Singapore records or documents provided other than a partial photocopy of the all-important 'five eights' account. Requests for vital information, including the electronic mail between London and Singapore, met with the deadpan response that they "have not been retained". Unfazed, the team requested access to the all-important computer file archive but were told it was "either missing or corrupted". The team did not press the point. They also did not consider the option of invoking statutory powers to enter the premises of Barings and seize documents—a fact to which we shall return.

Former Barings 'lone trader' Nick Leeson arriving under police escort in Singapore, where, as of December 1995, he is serving a six-and-a-half-year prison term. (AFP photo)

Undeterred, the inquisitive inquirers turned to Barings' auditors, hoping to gather the all-important data they needed to proceed with their investigation. Alas, they were disappointed. Coopers & Lybrand, who carried out the December year-end audit for 1994, refused the team access to either its work papers or members of its staff who undertook the audit, citing "its obligation to respect its clients' confidentiality". Strangely, Deloitte & Touche, who conducted the audit for the years 1993 and 1994, did likewise. Having exhausted the obvious choices, the team turned to the more exotic.

They approached SIMEX, the Singapore Money Exchange, which has significant records regarding the cash flow of funds from Baring Futures (Singapore) Pte Limited (BFS) that represented the massive margin calls that eventually totalled £827 million. SIMEX also has records covering the all-important 88888 account through which the 'unauthorised' trading of Nick Leeson was booked. SIMEX refused to provide the team with records of the this account as well as other "significant categories of documents".

Following the collapse of Barings, Singapore's Minister of Finance appointed Price Waterhouse as the Singapore Inspectors and authorised them to investigate the events leading to the collapse. Presumably they conducted their investigation with level-headed professionalism. However, they did not allow documents and other information they had gathered to be passed to their London colleagues in the Bank of England who were doing the same thing at the same time, and told them that this was due "to legal constraints in Singapore".

The Singapore High Court appointed Price Waterhouse as Judicial Managers on 27th February 1995. They became the legal repository of the majority of BFS records. Having provided some initial documents to the team, they then changed their minds and "thereafter did not permit the inquiry team access to any further documents requested, nor have they permitted interviews of BFS staff". Being wholly unfamiliar with Singapore law, I cannot comment on the dual role Price Waterhouse played as both the Inspectors and the Judicial Managers. Perhaps, like American banks, leading accounting firms have a system of 'Chinese walls' to guard against any conflict of interest, supposing there is any conflict in the first place.

Thus far we have most of the world luminaries of the accounting fraternity gathered together in this big hole in the banking balance sheet. Only one major name is missing from the commission merry-go-round: Ernst & Young. Perhaps unsurprisingly, we learn that they were appointed administrators of Barings Plc and "certain of its subsidiaries in the late evening of Sunday 26 February 1995". I wonder who is going to pick up the multimillion-pound 'fees' these firms will undoubtedly charge for their services.

Still buoyant and in fine fettle, the inquiry team approached the Singapore Commercial Affairs Department (CAD) which was charged with the responsibility of conducting criminal inquiries into the now familiar collapse. Surely they would cooperate. The CAD shrugged shoulders, simpered a few times, uttered the word "reglet", mumbled "so solly", and smiled a Chinese smile. Yes, they would like to cooperate, they really dearly would, but, unfortunately, the Judicial Managers (the nice people at Price Waterhouse) would not permit it.

Back in London, Leeson provided the Serious Fraud Office with important evidence contained in a letter. The SFO wasn't interested. Moreover, the letter is "confidential" and couldn't be released to members of the inquiry because of this. This is a Chinese wall, isn't it?

The brave band heaved a sad sigh and then brightened up as a sly thought struck them. There were other banks involved in the fiasco; and they were, after all, the Bank of England. Therefore, it stood to reason that members of their own banking fraternity would help them even if others outside the fraternity wouldn't. Flushed with excitement, they rushed to Citibank (Singapore), bankers to the doomed BFS. With details of funds transfers over BFS's account, they would be able to piece together a real humdinger of a cash-flow analysis. It is an established fact that a cash-flow analysis cannot fail but provide a clear trail of where the money went, how often, what sizes were involved, and so on. Every bank inspector knows the golden rule regarding cash-flow analysis. It's the oldest and most trustworthy tool in the book for unravelling anything, including embezzlement, criminal fraud, collusion and corruption (well, perhaps not the last two). Citibank declined to allow the team to inspect its records.

Being a thorough team, they decided to contact Banque Nationale de Paris (BNP) in Tokyo (BFS's only external account), but BNP refused them access to their records and staff. Suddenly discovering that Nick Leeson had his telephone tapped (in line with the practice of most banks, BFS and Barings London routinely taped their dealers' telephone calls), they rushed back to Barings and asked nicely if they could have copies of the telephone recordings. This request was not granted. Running out of ideas, the team turned to third parties whom they identified (but did not identify in the report) as having had a trading relationship with Leeson and BFS. However, these third parties also did not allow them to "examine their detailed trading records freely or conduct interviews with them".

The most salient points of the entire inquiry are summed up in the innocuous-sounding "Limitations on access to documents and individuals" section of the report. This section, more than the other 337 pages of the report combined, is the most revealing and has not been discussed in the press to any extent.

Despite doors closing in their faces at every turn, the team, undeterred, managed to write a 337-page report. By far the majority of information they gathered comes from those documents, records and formal interviews that Barings, London, allowed them or specially prepared for them—except, of course, those records that were not "retained" or were "missing or corrupted" or otherwise not available for inspection.

Presumably satisfied with their investigation, the inquiry team uncharacteristically whinged that they had "not had unfettered access to all relevant directors and staff of the Barings Group and its records". They even wryly observed that "we have not been able to perform some important investigation work" (witness the above). Nor could they verify the "strategy which lay behind the unauthorised trading conducted by BFS" and Leeson, nor "exclude the possibility that anyone else at Barings [Singapore, London, Tokyo or elsewhere] was involved in this unauthorised trading", nor even "exclude the possibility that third parties were involved", nor that funds transmitted to BFS may "have been misappropriated". But closing the introduction of their report on a high note, they were able to conclude that: "Despite these limitations, we consider that we have been able to ascertain the causes of the collapse of Barings..."—to wit, it was the lone trader who dun it, guv; honest! As Walter Matthau, playing the role of a cynical southern congressman in Oliver Stone's film, *JFK*, observed in regard to the Warren Commission report: "That dog don't hunt." Nor, apparently, do the proud heuristic boys of the Bank of England's inquiry team.

In the meantime, the sum of £830 million has apparently disappeared. In this context, the report says: "Almost all the figures, analysis and conclusions...are derived from the inquiry's analysis of a photocopy of the 88888 account statement originally found by Tony Hawkes." This account was BFS's 'dump' or error account where mismatched trades were temporarily lodged. We are told that Leeson hijacked the account and concealed all his naughty and massive loss-making trades in it. Despite this deeply cunning and highly deceptive ploy, Leeson daily forwarded details of the five-eights account to London for reconciliation. This practice continued over the course of the two years he was trading in Singapore. Meanwhile, London could not reconcile or fathom out the account and apparently disregarded it as unimportant.

On 23rd February 1995, all hell broke loose as Leeson and his wife legged it to Kuala Lumpur. Oddly, it was that very same day that Tony Hawkes, Group Treasurer, flew from Tokyo to Singapore, and in the pleasant cool of a Singaporean night he discovered, to his immense surprise, the mysterious and unimportant five-eights account brimming with spectacular losses.

Leeson, who was by now safely in Kuala Lumpur, allegedly faxed a resignation letter to his directors, Messrs Bax and Jones, somewhat meekly stating that he was sorry, his health was deteriorating and therefore he wished to resign. However, this alleged fax has not, unsurprisingly, been available for scrutiny. It is the same Bax and Jones to whom the inquiry report refers when noting that they were not "able to thoroughly investigate the management roles of Bax and Jones". (Bax and Jones declined to be interviewed.) Despite the fact that James Bax was the Regional Managing Director for Asia, whereas Simon Jones was the Director of Operations with specific responsibility for offices in Singapore, Kuala Lumpur, Bangkok and Jakarta, they have both flatly denied that Leeson reported to them. This begs the question why Leeson addressed his unseen resignation fax to them. Then again, Leeson had stated in his resignation fax that he was ill—so ill, it seems, that he didn't know to whom he reported.

In fact, there is no one within the Barings Group, not one person, who has accepted responsibility for managing or directing Leeson. He was so unmanaged that his proposed bonus, totalling £450,000 for the year ending December 1994, presumably was authorised by no one. In the same manner, his annual remuneration and other increasing perks were likewise authorised by the same no one, to the same extent that his 'unauthorised' trading activities were.

However, despite pulling in large losses year on year, Leeson, we are told, was able to report large profits. The cumulative losses for BFS started with £2 million for 1992 and increased to £23 million for 1993. Thereafter they leapt to £324 million for 1994 and almost tripled to £927 million (£830 million trading loss plus losses on foreign exchange and other charges) by March 1995. Commenting on Leeson's year-on-year figures, Peter Baring, Chairman of Barings, told the inquiry team that they were "pleasantly surprising", but then he maintains that he believed BFS was making a fortune. In any case, based upon the strength of this belief, he awarded himself a "proposed" 1994 bonus of £1,000,000, along with the other three most senior directors. George Maclean, a member of the board of directors, also commented on the ghostly, non-existent profits, saying they were "very surprising". And very surprising they turned out to be. Mr Maclean also got a "very surprising" "proposed" year-end bonus which was somewhat lower in amount than the Chairman's, but which in any case was substantial enough to keep his spirits raised, along with his fellow directors, as they slid into cushy new directorships at International Nederlanden Bank following the crash—a matter to which we shall return later.

The inquiry team, noting that they had not "analysed the build-up of the constituent part of these losses prior to 31 December 1994, as essential documents...have not been made available to us", were able to demonstrate that the cumulative losses stood at £324 million at December 1994. However, by means of a Chinese-made slide rule, group profits (Barings worldwide) for this same period were reported as £102 million before tax, after charging £102 million to the group bonus pool—a point to which we shall also return. Obviously the collapse came suddenly, as is witnessed by the December 1993 accumulated loss (hidden by Leeson?) of a miserly £23 million. However, by virtue of a mathematical system unknown to mankind (but known to accountants the world over), the group proudly announced pre-tax profits totalling £100 million—after charging £100 million to the group bonus pool. It's a neat trick if you've got the odd few hundred million quid handy, but the point to bear in mind is that Barings Singapore didn't have anything but losses for the preceding two years.

However, the fact is that someone was writing those tickets with Leeson, and, as his transactions racked up ever-increasing losses, his counterpart(ies) correspondingly racked up ever-increasing profits.

I hate to labour the point, but I've got this feeling that the same no one who didn't authorise Leeson's 'unauthorised' trading, and who obviously didn't authorise the 'authorised' bonus payment of £450, 000 or, for that matter, authorise Leeson's growing remuneration package, may have been the same no one who 'authorised' the accounts to show profits instead of losses. However, to be fair, the accumulated (and accumulating) realised losses were being hidden—weren't they? Despite the fact that hundreds of millions of pounds were flowing to Barings Singapore to meet margin calls in accord with SIMEX rules (a margin call is required when your open 'positions' are making a loss), the directors and management of Barings London apparently weren't worried. On the contrary, they were able to report profits for the year and thus accrue to themselves those richly deserved bonuses—even as they sank into oblivion.

MEANWHILE, IN TOKYO...

Meanwhile, London Treasury Department obligingly provided BFS with the zippy and relatively insignificant sum of £521 million, increasing by 24th February 1995 to £742 million, to fund its book (or to cover the massive losses, if you are more cynically minded). These sums were raised in unsecured loans on the interbank market from a syndicate of 20 Japanese banks, and, interestingly, represented more than double the Barings Group reported capital, which is quite a feat of leveraging. It is also strictly outside banking regulations and led to the bitter resignation of Chris Thompson, Senior Manager of Merchant Banking Oversight at the Bank of England, who is criticised in the report for allowing Barings exposure to exceed the stipulated 25 per cent of the group's capital base. Apart from Leeson himself, Chris Thompson is the only other casualty of the debacle to date—if one disregards the shareholders, which Barings directors have indeed done.

Banks lending such vast sums on an 'unsecured' basis on a balance sheet that is massively overleveraged and overexposed is not unheard of, even in these days of cowboy bankers, but it is rare and I dare say somewhat peculiar.[3] I am not suggesting that these 20 unidentified Japanese bankers were writing all those loss-making tickets with Nick Leeson. They wouldn't, would they? However, the fact is that <u>someone</u> (who is not identified in the report) was writing those tickets with Leeson, and, as his transactions racked up ever-increasing losses, his counterpart(ies) correspondingly racked up ever-increasing profits.

To be continued in the next issue of NEXUS Magazine...

Footnotes:

1. This despite his TV interview with the glazed and untutored David Frost who conveniently didn't ask any hard questions. Leeson, for his part, didn't demonstrate any particular willingness to reveal the extent of collusion between himself and directors of Barings. This is, it would appear, his only bargaining chip to avoid sentencing in Singapore for almost 15 years. My judgement is that he will fail for the same reasons that he was incarcerated in Frankfurt. However, this may depend on the outcome of the shareholders' recent petition to have him brought to London, following their announcement that they intend to prosecute Barings and its directors privately in an effort to recover their massive losses.

2. I have relied on the contents of this report, plus researched the relevant issues of *The Times* and *The Economist*, to prepare this article. If readers are able to provide additional material that I have not seen, I would be grateful to receive it.

3. The words, "a group", suggest to me a syndicate. If this is the case, then there are very serious doubts about this group's role in the affair. A syndicate is formed for the sole reason of spreading the risk between them. The fact that this group all provided 'unsecured' funding strikes me as extremely irregular. The normal course of events is that they would have approached Barings for a 'comfort letter' to protect them in the event that BFS crashed (which, of course, it did). This especially would have been the case in view of the large amounts involved and particularly because of the overleveraging of Barings' balance sheet, of which they couldn't fail to be aware. In the scheme of things, Barings was 'small fry' in the banking community. In my role as treasurer for a wholly-owned subsidiary of a major international bank, it was impossible to get funding on the interbank market or to establish lines of credit with other banks unless we provided comfort letters stating that the group would support us. I have queried the Bank of England on this matter and also requested the names of the 'group of 20'. Sam Davis of their press department politely advised me to contact the Administrators, Ernst & Young, because she wasn't sure that they (the BoE) had this information, but, if they did have it, it wouldn't in any case be available (phone call with this writer, 5 Oct. '95). Ernst & Young suggested that I speak to their PR company, Tavistock Communications, who suggested that the Singapore Administrators, Price Waterhouse (Singapore), were the proper people to whom to direct these questions. Informing Paul Desmond at Tavistock in a somewhat ribald manner that I doubted whether Price Waterhouse (Singapore) would provide this information to me if they hadn't provided it to the BoE, he promised to get back. Thus far this information has not been provided. Because of Japan's role in the Trilats (remember, this group was formed especially to bring Japan into the fold), it is certain that many if not all of the 20 banks are represented on the Commission. The Bushido families of Japan are still the leading elites in that nation and, between them, effectively own it. Most of the Japanese trademark names that are familiar to us are derived from these great houses.